(2) (2)

Nos. 89-1774 and 89-1775

FILED
AUG 10 1990
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1990

HENRY F. K. KERSTING, PETITIONER

v.

UNITED STATES OF AMERICA

RICHARD HONGSERMEIER, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the district court erred in enforcing a summons requiring a tax shelter promoter to identify his customers for 1984-1986 and to provide other information that would assist the government in conducting audits of their income tax returns for those years.

2. Whether the district court had jurisdiction to entertain a motion to intervene in a summons enforcement proceeding after the court had ordered the summons enforced and an appeal had been taken to the court of appeals from that order.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-17a)[1] is reported at 891 F.2d 1407. The order of the district court enforcing the summons (Pet. App. 35a-38a) is unreported. The order of the district court denying intervention, an evidentiary hearing, and

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[1] "Pet. App." refers to the appendix to the petition in No. 89-1774.

assessment of costs (Pet. App. 21a-25a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 13, 1989. A petition for rehearing was denied on February 16, 1990 (Pet. App. 1a-2a). The petitions for a writ of certiorari were filed on May 16, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Kersting has a history of promoting tax shelters of questionable validity.[2] The Commissioner of Internal Revenue has previously disallowed deductions claimed by participants in Kersting's shelters, and there are currently more than 1300 docketed Tax Court cases involving more than 600 investors in Kersting's shelters for taxable years prior to 1982. The IRS learned the names of those 600 individuals from documents that were seized from Kersting's offices pursuant to a search warrant in January 1981. Pet. App. 5a-6a & n.4, 56a; Pet. 21.

The Internal Revenue Service (IRS) is currently conducting an investigation to learn the identities of

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[2] Those shelters purport to generate substantial interest deductions for the participants when, in fact, the transactions that supposedly create the interest payments are circular loans or check swaps between 34 related entities that merely give the appearance that funds are transferred from one to another (Pet. App. 55a-56a). In a case involving one of Kersting's investors, the Tax Court held that the deductions generated by the transactions in Kersting's shelter program were not allowable because they did not create any true indebtedness, and no interest was actually paid. *Pike* v. *Commissioner*, 78 T.C. 822 (1982).

the participants in Kersting's shelter programs during the 1984-1986 period and to obtain information that will aid in auditing their income tax returns for those years. The IRS issued a "John Doe" summons (see 26 U.S.C. 7609) to Kersting requiring the production of all customer lists identifying the participants from 1984-1986 in any tax shelter plan promoted by him, any documents relating to those participants during those years, the books and records for the 34 corporations utilized by Kersting in the shelter promotions for 1981-1986, and bank and other records for those entities for 1984-1986 (Pet. App. 5a & n.2; see *id.* at 41a-45a, 58a-59a).

Section 7609(f) of the Internal Revenue Code (26 U.S.C.) requires the IRS to obtain authorization from a federal district court before serving a John Doe summons. The government must demonstrate to the court that the summons relates to an investigation of an ascertainable class of persons, that there is a reasonable basis for believing that the persons in that class may have failed to comply with the provisions of the Internal Revenue Code, and that the information sought is not readily available from other sources. The IRS made the necessary showing to the United States District Court for the District of Hawaii, and the district court issued an order authorizing service of the summons and also directing Kersting, if he objected to compliance, to appear before the court and show cause why the summons should not be enforced (Pet. App. 63a-70a).

Kersting objected to the summons, asserting that the summons was "issued as part of [an] on-going campaign of administrative bad faith on the part of the Commissioner" (No. 88-1738 C.R. E, Objections

to Summons 2).[3] The objections were supported by an affidavit filed by Kersting in which he stated that he was "firmly convinced that the above-referenced Summons is purely a continuation of the bad-faith campaign of persecution waged against him by the Internal Revenue Service since at least December of 1980" (No. 88-1738 C.R. E, Affidavit ¶ 4), noting that his offices had been searched and that he was aware of two grand jury investigations of his activities (*id.* ¶¶ 6, 13).

Following a hearing, the district court ordered the summons enforced (Pet. App. 35a-38a). The court found that the government had made the *prima facie* showing required for enforcement by *United States* v. *Powell*, 379 U.S. 48 (1964), and that Kersting had failed to rebut that showing. Specifically, the court found that the investigation had the legitimate purpose of investigating possible tax violations by Kersting's clients; that the requested documents met the standard for relevance; that the government did not already know the identities of all of Kersting's clients; and that there was no evidence that any persons who were the subject of the summons were currently subject to a referral to the Justice Department for criminal prosecution (Pet. App. 36a-38a; see also *id.* at 7a).[4]

2. In February 1988, Kersting filed a notice of appeal and a motion for a stay pending appeal (Pet. App. 7a & n.6). Both the district court (*id.* at 30a-34a) and the court of appeals (*id.* at 26a) denied the

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[3] "C.R." refers to documents contained in the excerpts of record on appeal.

[4] The court added that, if Kersting could show that there was such a referral, he did not have to provide information regarding the persons covered by the referral (Pet. App. 38a).

request for a stay. Subsequently, on May 31, 1988, the district court orally held Kersting in contempt for failure to comply with the summons (*id.* at 8a) and warned him that he would be fined $1,000 per day if he failed to produce the records as ordered (Nos. 88-15549 and 88-15565 C.R. Y, May 31, 1988 Tr. 26; see Pet. 8). Kersting thereafter produced some of the summoned records and moved for discharge from prior orders of the district court, claiming that he had substantially complied with the summons; the government in turn claimed that Kersting had not fully complied (Pet. App. 8a). The district court refused to consider the merits of this motion, finding that it did not have jurisdiction over the matter while Kersting's appeal from the enforcement order was pending (*ibid.*). No written order holding Kersting in contempt was ever entered, and no further proceedings were held on the government's motion to have Kersting held in contempt.

3. At the May 31, 1988, hearing, petitioners in No. 89-1775—11 individuals who had invested in Kersting's programs prior to 1982 and are among those investors currently engaged in litigation in the Tax Court (see p. 2, *supra*)—moved to intervene in the summons enforcement proceeding. The district court denied the motion because a notice of appeal had already been filed from the enforcement order, explaining that "there is no longer any proceeding in which to participate" and that the "court no longer has any jurisdiction" to consider the motion (Pet. App. 24a). The court also denied for the same reason several other motions made by Kersting at that time, which pertained to discovery and the recovery of costs of complying with the summons. *Id.* at 21a-25a; see also *id.* at 8a-9a.

4. The court of appeals consolidated all of the appeals from the district court—Kersting's appeals from the enforcement order and from the district court's refusal to consider his post-appeal motions and the appeal of petitioners in No. 89-1775 from the denial of their motion to intervene. The court of appeals affirmed the order enforcing the summons (Pet. App. 11a-15a), holding that the government had made a sufficient *prima facie* case to warrant enforcement of the summons and that Kersting had failed to rebut that showing. In particular, the court concluded that the district court had not been clearly erroneous in finding that all of the summoned documents were relevant to the investigation (*id.* at 12a-14a), and it found that "[t]he summons had a legitimate purpose: to find out who had been investing in Kersting's schemes" (*id.* at 14a). The court of appeals also affirmed the district court's holding that it lacked jurisdiction to consider the investors' motion to intervene and the motions filed by Kersting after he had filed a notice of appeal from the enforcement order, finding that these matters were not collateral to the subject of the appeal (*id.* at 15a-17a).[5]

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[5] The court of appeals also noted that Kersting's appeal of the enforcement order would be moot if he had substantially complied with the order, but the court concluded that the record was inadequate for it to determine whether there had been compliance (Pet. App. 10a-11a). The court of appeals directed the district court to determine on remand whether Kersting had substantially complied and, if it determined that a live controversy remains, to consider the merits of the motions previously denied by the district court for lack of jurisdiction (*id.* at 11a, 17a).

ARGUMENT

1. Petitioners' primary contention (89-1774 Pet. 10-15; 89-1775 Pet. 9-10) is that this Court should grant certiorari to decide whether compliance with a summons moots an appeal from an order enforcing that summons. That question is not presented here. The court of appeals did state its view that compliance with a summons would moot an appeal from an enforcement order,[6] but that statement did not form the basis for its decision. Rather, the court of appeals ruled that it could not determine on the present record whether Kersting had complied with the summons, and therefore it proceeded to consider the enforcement order on the merits, ruling that it should be affirmed and the case remanded to the district court for further proceedings. Thus, the court of appeals did not find that any of the appeals in this case was moot, and it would afford no relief to any of the petitioners if this Court were to state that compliance with a summons does not moot an appeal from an enforcement order. Petitioners are simply seeking an advisory opinion on a question that is not before this Court.

2. The issue that is properly presented here by petitioner Kersting is his claim (Pet. 15-23) that the summons should not have been enforced because it was not issued in good faith. This contention is entirely factbound and was correctly rejected by both courts below. There is no reason for further review by this Court.

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[6] This statement accords with the law previously established in the Ninth Circuit and in every other circuit that has considered the question, except for the Third Circuit. See Pet. App. 10a n.8.

Petitioner Kersting's allegations do not demonstrate any impropriety by the IRS in the conduct of its investigation or the issuance of the summons. Kersting argues (Pet. 15-16, 19-22; see also 89-1775 Pet. 15-17) that the IRS acted in bad faith because the stated reason for issuing the summons was to obtain the names of Kersting's clients during the 1984-1986 period when the IRS already knew the names of more than 600 Kersting clients who were currently litigating in the Tax Court the validity of deductions claimed for investments in tax shelters promoted by Kersting prior to January 1981. There was, however, no reason to believe that the same individuals who had invested in Kersting's schemes before January 1981 comprised his investors in 1984, 1985, and 1986. As the court of appeals stated (Pet. App. 14a), Kersting's "contention is equivalent to Kersting saying that the IRS must take his word for what is in his records, which, of course, it is not required to do." [7]

Petitioner Kersting also contends (Pet. 15, 22-23) that the summons was invalid under Section 7602(c) of the Code because Kersting and, allegedly, some of his investors were subjects of a grand jury investi-

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[7] Petitioner Kersting also asserts (Pet. 15, 22) that the IRS sought "to avoid the notice requirements of Section 7609(a)" of the Code. This assertion is entirely without foundation. Section 7609(a) imposes certain notice requirements upon the IRS when it issues a summons to certain specifically defined "third-party recordkeeper[s]," such as banks, attorneys, accountants, etc.; that provision clearly does not include tax shelter promoters such as Kersting. The IRS was not required to give notice to anyone before issuing a summons for Kersting's records, and there is no basis for suggesting that the use of a "John Doe" summons here was intended to avoid some notice requirement or was improper in any other way.

~~gation in 1982 and 1983. Section 7602(c) provides~~

gation in 1982 and 1983. Section 7602(c) provides that no summons shall be issued with respect to a person if a Justice Department referral, which includes a recommendation for a grand jury investigation, is in effect with respect to that person. Although Kersting himself was informed that he would not be prosecuted, and therefore he concededly was no longer subject to a referral within the meaning of Section 7602(c), he alleges that there may remain outstanding Department of Justice referrals with respect to the other unnamed investor/targets. This objection to the summons in this case is without merit. First, Section 7602(c)(3) explicitly states that for purposes of that section each taxable year "shall be treated separately." Accordingly, even if there were outstanding referrals relating to grand jury investigations for pre-1982 years, that would not defeat this summons, which was inquiring into tax liabilities for 1984-1986. Moreover, the government represented to the district court that the grand jury investigations had terminated and that there was no ongoing grand jury investigation with respect to any of the investors. See No. 88-1738 C.R. I, Aug. 24, 1987 Tr. 14-15. And, finally, the district court's enforcement order specified that Kersting was not required to produce records with respect to any investor who he could demonstrate was under grand jury investigation (Pet. App. 37a-38a).

In sum, the district court correctly held that petitioner Kersting had not made a sufficient showing to justify either an evidentiary hearing or a refusal to enforce the summons. There is no reason for this Court to review the court of appeals' affirmance of that conclusion (see Pet. App. 15a).

3. Petitioners in No. 89-1775 contend (Pet. 10-14) that the district court should have granted their motion to intervene. But petitioners' argument is de-

voted to the merits of their intervention motion, a matter that was not considered by either of the courts below. Rather, the district court rejected the intervention request because the prior filing of a notice of appeal had divested it of jurisdiction over the summons enforcement action (Pet. App. 24a), and the court of appeals affirmed on this ground (*id.* at 16a). Petitioners advance no authority or argument to suggest that this jurisdictional ruling was erroneous. Accordingly, they present no basis for disturbing the judgment below; their contentions on the merits of the intervention question are not properly presented.[8]

Similarly, there is no basis for this Court to review the merits of petitioner Kersting's various motions that were denied by the district court for lack of jurisdiction. In particular, Kersting's arguments on the merits of its motion to recover in advance the costs of complying with the summons (Pet. 25-27) were not considered by either court below and are not properly presented here.[9]

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[8] Indeed, the court of appeals directed the district court on remand to consider the merits of the intervention motion, in the event the court determines that the case is not moot (Pet. App. 17a).

[9] Petitioner Kersting's arguments for recovery of costs are, in any event, without merit. Section 7610 of the Code provides that a summoned person may be reimbursed for "reasonably necessary" costs incurred directly in searching for and reproducing the summoned data; 26 C.F.R. 301.7610-1 establishes rates of reimbursement and also provides that no payment will be made until full compliance with the summons has been accomplished and the summoned party has submitted an itemized bill to the IRS. The courts have consistently rejected the contention that an unconstitutional taking occurs when the reimbursement provided by statute fails to cover

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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completely the costs of compliance incurred by a subpoenaed or summoned party. See, *e.g.*, *United States* v. *Continental Bank & Trust Co.*, 503 F.2d 45 (10th Cir. 1974); *United States* v. *Dauphin Deposit Trust Co.*, 385 F.2d 129, 130 (3d Cir. 1967), cert. denied, 390 U.S. 921 (1968). And the courts have also consistently recognized that advance reimbursement is not a precondition to enforcement of a summons. See, *e.g.*, *In re Tax Liabilities of: John Does, All Unknown Employees of Boundary Waters Restaurant*, 866 F.2d 1015, 1022 (8th Cir. 1989); *United States* v. *Schmidt*, 816 F.2d 1477, 1482-1483 (10th Cir. 1987); *United States* v. *Money*, 744 F.2d 779, 780 (11th Cir. 1984). Thus, Kersting's contention that he is entitled to an award of costs in excess of that allowed by Section 7610 is, at best, premature.

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